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*“Ginnie Mae is an integral part of the  
Clinton Administration’s push to add  
eight million new homeowners  
by the year 2000 and build one America  
– an America where opportunity and success are  
within reach of all our citizens.”*

**Secretary Andrew Cuomo**

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The Honorable Andrew Cuomo  
Secretary  
United States Department of Housing and Urban Development  
Washington, DC 20410

Dear Mr. Secretary:

I am pleased to present to you the audited financial statements of the Government National Mortgage Association (Ginnie Mae) for the fiscal year ended September 30, 1997. Once again, Ginnie Mae has received an unqualified opinion from the independent auditors, KPMG Peat Marwick LLP, with no findings of material weaknesses or reportable conditions.

During fiscal year 1997, Ginnie Mae approached \$1.3 trillion of original issues of mortgage-backed securities guaranteed since 1970. We are quite proud of our continuing accomplishments and our role in the Department's commitment to supporting affordable homeownership for low- and moderate-income families in America.

Operating results for fiscal year 1997 exceeded historic performance levels and are quite favorable. At year end, our mortgage-backed securities outstanding totaled \$530.6 billion, a \$32.7 billion or 7 percent increase from fiscal year 1996. Ginnie Mae's net revenues were \$601.2 million in fiscal year 1997, a 17 percent increase and historic record high, as compared to \$515.5 million in fiscal year 1996. Ginnie Mae's mortgage-backed securities program guaranteed the issuance of \$97.6 billion in mortgage-backed securities last year, thereby providing capital for the purchase or refinancing of about 1.1 million homes. Over its lifetime, Ginnie Mae's mortgage-backed securities have financed homeownership opportunities for over 21 million American families.

Ginnie Mae completed a Business Process Reengineering (BPR) effort in 1996. In fiscal year 1997, Ginnie Mae continued its efforts to ensure its commitment to customer service. Several initiatives were implemented in 1997 through efforts to bring new products and technology to the market. The commitment to customer service and the resultant organizational structure enables Ginnie Mae to be more responsive to change; focus more resources on mitigating and managing its business risks; improve service to our customers; work more closely with our partners; and improve monitoring of contractor performance.

In late fiscal year 1997 Ginnie Mae began a BPR effort focused specifically on the Office of Finance. It is expected that subsequent implementation of the recommendations will result in an increased use of technology to enhance the efficiency of the Office and to improve its capability to provide greater financial analysis capacity to Ginnie Mae's management.

In the midst of this refinement, Ginnie Mae continues to fulfill its mandate to promote access to mortgage credit throughout the nation by increasing the liquidity of investment capital available to the residential mortgage finance market. Ginnie Mae's Targeted Lending Initiative has proven to be tremendously effective in helping to increase homeownership levels in targeted central city communities. Its objective was to bring an additional

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\$1 billion of investment funding annually to 72 designated targeted lending areas. We have not only met, but exceeded this goal. We increased funding by more than \$1.3 billion in fiscal year 1997. Total lending in these targeted areas was up by more than 12 percent in fiscal year 1997 compared to the 1994-1996 average annual production in these targeted lending areas.

Incorporation of technology has enhanced Ginnie Mae's efficiencies and capabilities. The World Wide Web has become an essential communications channel for educating and informing our customers and the public. It has enabled Ginnie Mae to improve customer service by providing stakeholders with another channel for obtaining information about Ginnie Mae and its programs. The Ginnie Mae Business Center centralizes and provides a substantial improvement in training capability and capacity for our issuers. The newly implemented Electronic Data Interchange, through a more efficient method of transferring data, offers substantial promise to realize efficiencies in how Ginnie Mae conducts its business.

Our business processes and initiatives, organizational structure, and technology improvements are the hallmark of the new Ginnie Mae. Ginnie Mae's commitment and presence in the capital markets provide continuous opportunities for efficiencies, economies of scale, and further refinement of the infrastructure that encourages the achievement of our mission.

We are proud of our continued accomplishments as part of the Department's historic role in helping to make the American dream of homeownership a reality for millions of low- and moderate-income American families.

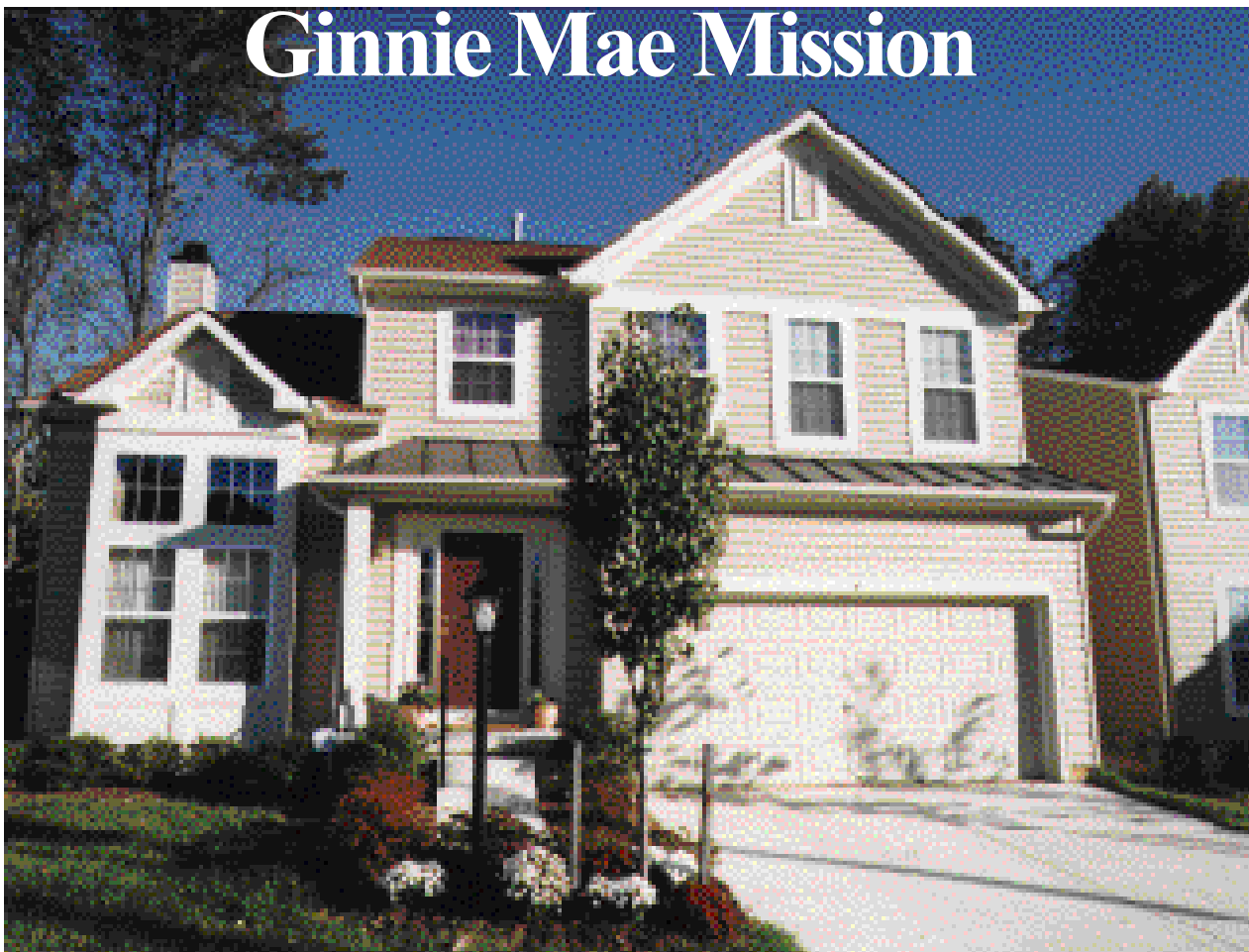
Sincerely,

A handwritten signature in dark ink, appearing to read "Kevin G. Chavers", followed by a long horizontal flourish line.

Kevin G. Chavers  
President  
Ginnie Mae

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# Ginnie Mae Mission



**To support expanded affordable housing in America  
by providing an efficient government-guaranteed  
secondary market vehicle linking the capital markets  
with Federal housing markets.**

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## Overview of Ginnie Mae

The Government National Mortgage Association (Ginnie Mae) was created in 1968 through amendment of Title III of the National Housing Act. Ginnie Mae, a wholly-owned government corporation within the Department of Housing and Urban Development, was established to support Federal housing initiatives by providing liquidity to the secondary mortgage market and by attracting capital from the Nation's capital markets into the residential mortgage markets. Ginnie Mae's operations are overseen by the Secretary of Housing and Urban Development and the President of Ginnie Mae, both of whom are appointed by the President of the United States and confirmed by the United States Senate.

Ginnie Mae guarantees the timely payment of principal and interest on securities issued by private institutions and backed by pools of Federally-insured or guaranteed mortgage loans. The Ginnie Mae guaranty is backed by the full faith and credit of the United States. Each year Ginnie Mae-guaranteed securities provide the financing for approximately 95 percent of all loans insured or guaranteed by the Federal Housing Administration (FHA) and the Department of Veterans Affairs (VA).



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## INTRODUCTION

Ginnie Mae was created in 1968, during a period of rapid change in the mortgage finance industry. From this dynamic environment, Ginnie Mae emerged as a pioneer with the development of the Mortgage-Backed Securities (MBS) program. MBSs issued under this program provide a vehicle to efficiently and effectively generate capital by providing lenders with the liquidity to maintain a steady supply of credit available for housing.

Over its lifetime, Ginnie Mae's mortgage-backed securities have financed homeownership opportunities for over 21 million American families. Today, the mortgage finance industry faces new challenges that demand creative leadership and innovative solutions. Ginnie Mae has repositioned itself to meet new market challenges while playing a pivotal role in achieving the Department's goal of providing low-cost mortgage credit to traditionally underserved sectors of the housing market. Ginnie Mae's mission and goals and related accomplishments for fiscal year 1997 are discussed in more detail in this report.

## CORPORATE GOALS

Ginnie Mae's mission and strategic vision have been captured in three overarching goals. These goals guide the organization in the prioritization of its resources and activities to focus on outcomes rather than outputs and processes. The goals Ginnie Mae holds itself accountable to are stated below.

### Goal 1: Excellence in Customer Service

Ginnie Mae will provide excellent service to its customers. "Customers" shall include program participants (e.g., issuers and investors) and other stakeholders (e.g., homeowners and prospective homeowners, taxpayers, bond holders, the FHA, the VA, and the Rural Housing Service (RHS)).

### Goal 2: Leadership Role in the Industry

Ginnie Mae will play a leadership role in the affordable lending marketplace. Leadership includes taking action to increase affordable homeownership and rental housing nationwide through the introduction of new products and expansion of affordable mortgage credit.

### Goal 3: Integrity and Excellence in Financial Management

Ginnie Mae will manage its financial risk.

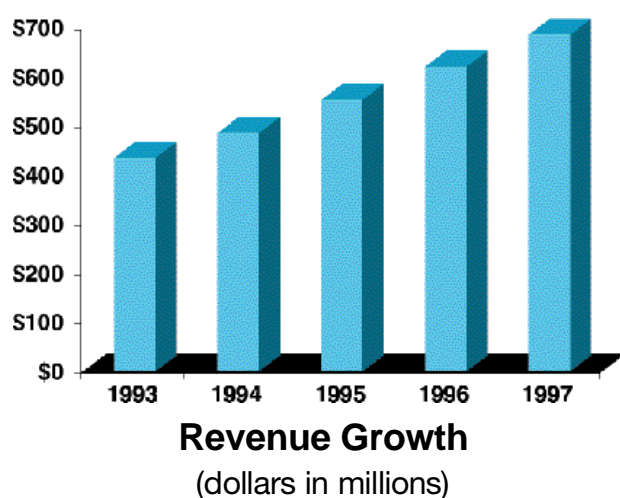


# Management's Discussion and Analysis of Financial Position and Results of Operations

## FINANCIAL HIGHLIGHTS OF 1997

Fiscal year 1997 was a year of strong financial achievement marked by substantial increases in both revenues and assets. Ginnie Mae's new financial management team reported record net income of \$601.2 million, a 17 percent increase from \$515.5 million in fiscal year 1996. Revenues increased by 11 percent, to \$686.7 million from \$621 million in 1996, and total assets increased 13 percent, to \$5.7 billion from \$5 billion in 1996. These record growth rates are indicative of strong financial management and the continued growth in Ginnie Mae's mortgage backed securities during fiscal year 1997.

The combination of favorable mortgage market conditions and strong program management have resulted in an increase in the outstanding MBS portfolio which has generated increased guaranty and commitment fee revenue. In fiscal year 1997, MBS program income rose to \$353.8 million from \$335.2 million in fiscal year 1996. Total expenses as a percentage of total revenues declined from 5.8 percent in fiscal year 1996 to 5.6 percent in fiscal year 1997.



Commitment authority was issued in the amount of \$98.9 billion, a 10 percent decrease from the prior year. The \$97.6 billion of MBS issued in fiscal year 1997 resulted in a 4 percent decrease in MBSs issued over the prior year. The outstanding MBS balance at the end of fiscal 1997 increased 7 percent to \$530.6 billion. Fiscal year 1997 production provided the capital to finance the purchase or refinance of homes for approximately 1.1 million American families.

Strong financial performance during fiscal year 1997 produced additional growth in Ginnie Mae's guaranty fund. Excess revenues over expenses are invested in U.S. Government securities, and provide the capital base to support Ginnie Mae's mission. To date, Ginnie Mae's earnings and fund balance have provided the capital to finance its operations and, as a result, Ginnie Mae has not needed to obtain funds through Federal appropriations.

## RESULTS OF OPERATIONS

### MBS Program Income

MBS program income includes Guaranty Fees, New Issuer Fees, Commitment Fees, Handling Fees, and Transfer of Servicing Fees. Guaranty Fees and Commitment Fees comprise 98 percent of the total MBS program revenues. Guaranty Fees represent income streams earned by providing Ginnie Mae's guaranty of "the full faith and credit of the U.S. Government" to MBS issues. These income streams are recognized over the life of the outstanding mortgage-backed securities. Commitment Fees represent income Ginnie Mae earns for providing approved issuers with authority to pool mortgages into Ginnie Mae mortgage-backed securities.

## Three Year Financial Highlights

September 30,	1997	1996	1995
(Dollars in thousands)			
<b>Balance Sheet &amp; Liquidity Analysis</b>			
Funds with U.S. Treasury	\$155,800	\$131,200	\$92,600
U.S. Government Securities	\$5,382,000	\$4,785,100	\$4,248,500
Total Assets	\$5,682,900	\$5,042,400	\$4,528,600
Investment of U.S. Government	\$5,134,600	\$4,533,400	\$4,033,300
Total Liabilities	\$548,400	\$509,000	\$495,300
Total RPB Outstanding <sup>(1)</sup>	\$530,553,333	\$497,887,840	\$464,237,781
LLR <sup>(2)</sup> & Investment of U.S. Government	\$5,642,300	\$5,005,100	\$4,489,100
Investment of U.S. Government as a percentage of Average Total Assets	95.75%	94.73%	93.24%
LLR & Investment of U.S. Government as a percentage of RPB	1.06%	1.01%	0.97%
Capital Adequacy Ratio <sup>(3)</sup>	1.05%	1.00%	0.96%
<b>Statement of Revenues and Expenses &amp; Profitability Analysis</b>			
Revenues	\$686,700	\$621,000	\$553,700
Excess of Revenue Over Expenses	\$601,200	\$515,500	\$498,500
MBS Program Income	\$353,800	\$335,200	\$311,800
Interest Income	\$318,200	\$274,100	\$229,900
Administrative Expenses & Other Expense	\$9,300	\$9,100	\$8,900
Total Expense as a percentage of Average RPB	0.0075%	0.0075%	0.0077%
Provision for Loss as a percentage of Average RPB	0.009%	0.014%	0.004%

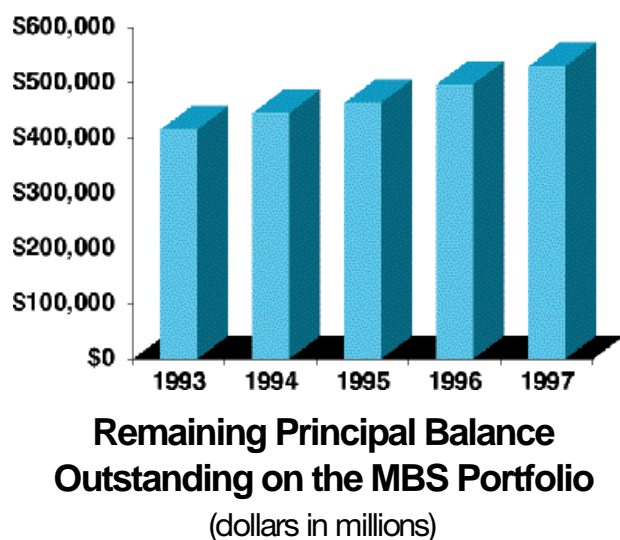
(1) RPB (Remaining Principal Balance) of Ginnie Mae MBSs

(2) Loan Loss Reserve established to account for probable future losses

(3) Investment of U.S. Government plus Loan Loss Reserve divided by the sum of Total Assets and Remaining Principal Balance

Commitment Fees decreased 12 percent from \$22.3 million in 1996 to \$19.6 million in 1997. This decrease is a direct result of a decline in issuer demand for new commitments. New commitments issued by Ginnie Mae amounted to \$98.9 billion during fiscal year 1997, a 10 percent decrease from fiscal year 1996. The decrease in commitment and guaranty activity resulted from a decline in MBS issuance activity.

Steady growth in the MBS portfolio drives the increase in MBS program income. MBS Guaranty Fees increased 7 percent, to \$326.4 million from \$305.2 million in 1996. The Guaranty Fees are collected on the aggregate principal balance of the guaranteed securities outstanding of the non-



defaulted issuer portfolio.

### Interest Income

Ginnie Mae funds its investment portfolio through its excess revenues over expenses. As a result, the corresponding interest income has steadily increased over the past five years. For fiscal year 1997, interest income increased 16 percent to \$318.2 million from

\$274.1 million in 1996. This increase is directly related to Ginnie Mae's investment strategy, and its corresponding increasing investment portfolio. Ginnie Mae invests the excess of its revenues over expenses only in U.S. Government securities, resulting in sound portfolio management.

### Multiclass Revenues (Other Income)

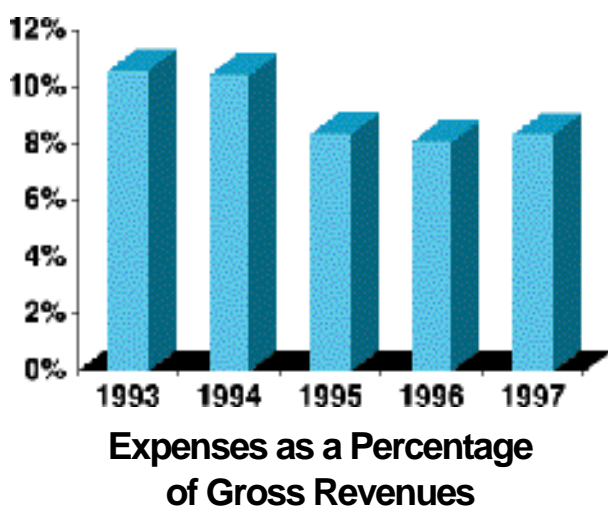
Other Income is comprised primarily of REMIC (Real Estate Mortgage Investment Conduit) and Platinum Program Fees and miscellaneous income earned from the Ginnie Mae II portfolio. The Other Income balance fluctuates with issuance activity. During periods of moderate REMIC issuance activity Other Income will maintain a stable earnings trend. During fiscal year 1997, Other Income increased 27 percent over the prior year. Ginnie Mae issued Platinum products during fiscal year 1997, which resulted in net fees of \$12.5 million. Ginnie Mae recognizes a portion of REMIC and Platinum Program Fees in the period the fees are received, with the balance deferred and amortized as Other Income over the life of the financial investment.

Additional information on REMIC activity is presented under the section entitled "Ginnie Mae Multiclass Program."

### MBS Program and Administrative Expenses

MBS Program and Administrative Expenses are incurred to carry out Ginnie Mae's programs and initiatives. These costs include contractor services, personnel, compensation, printing and other administrative functions. MBS Program and Administrative Expenses had an increase of 7 percent during fiscal year 1997 to \$38.7 million from \$36.2 million in fiscal year 1996. This modest increase in expenses, in light of the increased volume of MBS securities issued, illustrates Ginnie Mae's ability to efficiently administer its program activities.

Ginnie Mae was able to hold the growth of expenses to a modest level, while launching new products and experiencing a significant increase in program activities. Revenues and MBSs outstanding grew significantly at a rate of 11 percent and 7 percent, respectively. Total expenses as a ratio of total revenues declined from 5.8 percent in fiscal year 1996 to 5.6 percent in fiscal year 1997. Additionally, MBS Program and Administrative Expenses as a percentage of average RPB declined over the last five-years from 0.0093 percent to 0.0075 percent. This favorable trend reflects Ginnie Mae's commitment to the prudent stewardship of its assets.



### Credit-Related Expenses

Credit-related expenses include Ginnie Mae's provision for loss and defaulted issuer portfolio costs. The provision for loss is charged against income in an amount considered appropriate to maintain reserves for losses at levels management determines adequate to absorb potential losses from defaulted issuer portfolios and program losses. The provision for loss decreased in 1997 to \$46.8 million from \$69.3 million in the prior year, as a result of positive experience with the defaulted issuer portfolio.

## LIQUIDITY AND CAPITAL ADEQUACY

### Financial Models

Ginnie Mae's Policy and Financial Analysis Model (PFAM) provides information regarding future cash inflows/outflows, Ginnie Mae's financial position, and indicators of the financial and policy impact of changes in economic conditions and program policy. Using the PFAM, Ginnie Mae is better able to project the adequacy of its capital under a variety of economic conditions and to understand the financial implications of policy decisions.

In fiscal year 1997, Ginnie Mae made significant enhancements to the PFAM. The PFAM now calculates Ginnie Mae's credit subsidy rate in accordance with the Office of Management and Budget (OMB) credit subsidy module and prepares OMB formatted output based on a redesigned budget module. In addition, enhancements were made to the single-family and multifamily economic and cash flow models. The single-family model code was optimized, significantly reducing the time required for the model to generate financial statements and analyses. Additionally, a total of six FHA loan types are now modeled within the single-family cash flow model which provides a more detailed estimation of cash flows arising from FHA-insured loans. Development of a multifamily micro-simulation model during fiscal year 1997 has provided more representative cash flow simulations for the multifamily MBS program. Finally, recent pool and loan data from FHA-insured and VA-guaranteed loans were added, and variables used as assumptions within the model were updated to reflect current economic conditions and program structures. The PFAM incorporates information on specific issuer portfolios linked to individual loan collateral on a loan-by-loan basis. This allows for more accurate and detailed financial projections and a more sophisticated simulation of future issuer performance.

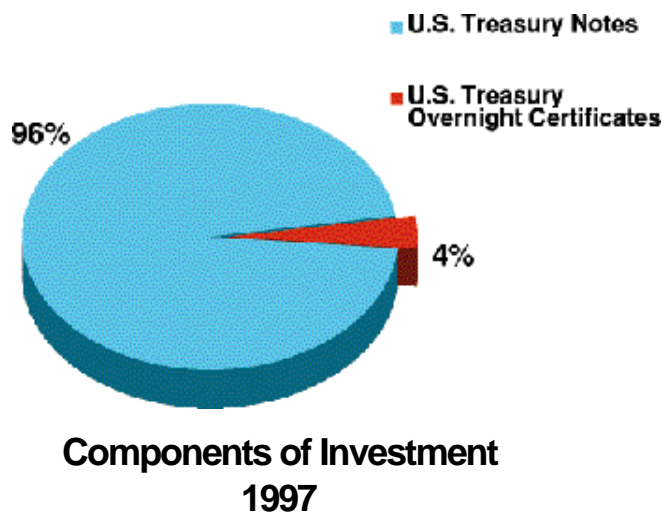
## Liquidity

Ginnie Mae's role in supporting expanded affordable housing in America through secondary market vehicles is ongoing through the use of the guaranty of full faith and credit of the U.S. Government. Thus, these program activities require a degree of liquid assets to further Ginnie Mae's initiatives. These needs are driven by the development of new secondary market vehicles, the timely payment of pass-throughs to security holders, and general operations. Due to successful cash management, program management and commitment to cost containment, Ginnie Mae has not been required to obtain congressional appropriations or other debt financing sources.

Ginnie Mae's primary sources of cash are MBS Guarantee Fee Income, Commitment Fee Income and interest income. As a result of these sources, at September 30, 1997, Ginnie Mae reported funds in the U.S. Treasury of \$155.8 million compared with \$131.2 million at September 30, 1996. The increase in the funds in the Treasury is influenced by the Credit Reform Act of 1990. In accordance with the Credit Reform Act of 1990, Ginnie Mae has segregated funds held with the U.S. Treasury between Liquidating and Financing accounts. Funds received from activity originating prior to fiscal year 1991 are accounted for in the Liquidating accounts, while funds received from MBS fees for activity originating after fiscal year 1991 are maintained in the Financing accounts. For Credit Reform purposes, funds in the Financing account cannot be invested, but are deposited into a quarterly based interest bearing account with the U.S. Treasury.

In addition to the funds in the U.S. Treasury, Ginnie Mae's investments totaled \$5.4 billion, a 12.5 percent increase from \$4.8 billion in the prior year. Ginnie Mae continued its investment strategy of extending the maturity range of its securities portfolio, thereby increasing interest income while reducing the risk of cash shortages leading to the premature redemption of securities. Of the \$5.4 billion investment balance at September 30, 1997,

\$217.7 million was held in overnight certificates. The balance of the portfolio's maturities are spread over time to ensure that Ginnie Mae has a ready source of funds to meet emergency liquidity needs.

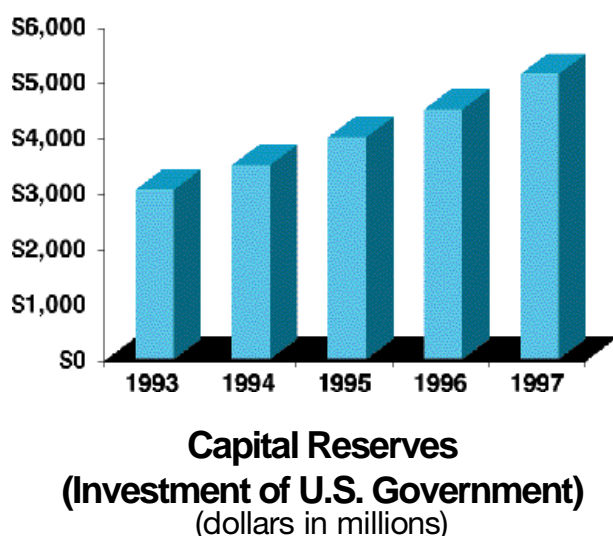


## Capital Adequacy

Ginnie Mae's activities involving the guaranty of MBSs have historically operated at a profit, and Ginnie Mae has incurred no borrowings to finance its credit operations. Ginnie Mae's net income builds its capital base and strengthens its programs. Ginnie Mae also maintains adequate capital to withstand any downturns in the housing market which, in turn, may cause severe defaults. Backing Ginnie Mae's capital is, of course, the full faith and credit guaranty of the U.S. Government.

At September 30, 1997, Ginnie Mae had an Investment of U.S. Government balance of \$5.1 billion after establishing reserves for losses on its credit activities compared with \$4.5 billion at September 30, 1996. Ginnie Mae's net earnings are used to build sound reserves. Over the past three years, Ginnie Mae has increased its capital ratio (investment of government plus loan loss reserves as

a percentage of total assets and RPB) from 0.96 percent to 1.05 percent. To determine the strength of its capital position, Ginnie Mae uses a “stress test” methodology.



## GINNIE MAE INITIATIVES

In response to the dynamic changes in mortgage finance, Ginnie Mae has increased its efforts to bring new products to the marketplace.

### Multiclass Products

Multiclass products were introduced to make Ginnie Mae securities more attractive to investors. The Ginnie Mae Multiclass securities program consists of REMIC Securities and Ginnie Mae Platinum Securities, which both use Ginnie Mae I and II mortgage-backed securities as collateral. Ginnie Mae organized and sponsored a symposium on the development of the Financial Asset Securitization Investment Trust (FASIT) as it relates to Ginnie Mae MBS securities. After the anticipated FASIT regulations are issued by the Internal Revenue Service (IRS), brokers/dealers can be expected to propose structural innovations that will allow them to provide

additional customized securities to investors.

In 1997, Ginnie Mae became the first agency to permit brokers/dealers to deliver offering materials electronically. Ginnie Mae announced three new multiclass products:

**Ginnie Mae Re-REMICs:** The new Ginnie Mae Re-REMIC may be backed by Ginnie Mae, Fannie Mae and/or Freddie Mac REMICs, provided that the REMIC is ultimately backed by Ginnie Mae MBS. These securities create a unique opportunity for investors to combine REMICs from three different guarantors.

**Modifiable and Exchangeable REMIC Certificates:** Modifiable and exchangeable (MX) REMIC certificates may be included in the structure of Ginnie Mae REMICs. This structuring flexibility gives REMIC investors the ability to exchange specified REMIC classes for proportionate interests in the related MX classes.

**Callable Trusts and Callable REMICs:** Callable trusts consist of pairs of classes, designated A and B. The A class may be redeemed at the option of the investor in the B class. These securities allow investors to better manage prepayment risk by providing lockout periods and call redemptions at known prices. Callable trusts may be used to back a REMIC to further customize the securities as demanded by investors.

Ginnie Mae has experienced continued success with its Platinum program. Since the inception of the Ginnie Mae Platinum Security program in November 1994, over 157,000 MBS pools have been consolidated into 640 Ginnie Mae Platinum pools totaling more than \$52.4 billion in securities. In September 1997, Ginnie Mae increased the number of business days each month that are available to Ginnie Mae Platinum Sponsors for submission and settlement of Ginnie Mae Platinum pools. This action gave Ginnie Mae customers an additional seven business days to improve the liquidity of their mortgage-backed security pools.

Under changing economic and market conditions, a range of products will allow Ginnie Mae to better satisfy investor needs and thus ensure continuous availability of capital to the mortgage markets.

### **Ginnie Mae Targeted Lending Initiative**

In fiscal year 1997, Ginnie Mae began an initiative to help raise homeownership levels in central city areas. This effort, the Targeted Lending Initiative, provides financial incentives for lenders to increase loan volumes in traditionally underserved areas. By increasing lender activity in these targeted areas, Ginnie Mae provides families and households with additional opportunities to achieve homeownership.

During fiscal year 1997, Ginnie Mae's annual goal of an additional \$1 billion in new mortgage credit for the Targeted Lending areas was exceeded by more than 12 percent. Participation continues to grow since its inception in October 1996. With \$1.3 billion in funding available for this program, over \$1.1



billion in net new loans were initiated during the year. Performance analysis indicates that lending has increased from the previous year. Ginnie Mae is confident that the success of the Targeted Lending Initiative will continue and is looking forward to another banner year in fiscal year 1998.

Under the Targeted Lending Initiative, Ginnie Mae reduced its guaranty fee by up to 50 percent when approved issuers originate (or purchase) home mortgage loans in one of 72 designated urban communities around the nation and place them in Ginnie Mae pools. The Ginnie Mae guaranty fee may be reduced by 1 to 3 basis points on a pool, depending on the percentage of unpaid principal balance of eligible FHA-insured and VA-guaranteed loans in the pool.

72 eligible communities in 69 Metropolitan Statistical Area (MSAs) have been designated by HUD as Urban Empowerment Zones, Supplemental Empowerment Zones, Enterprise Communities, or Enhanced Enterprise Communities. Underserved areas in these 69 MSAs are also eligible for the new product.

All Ginnie Mae issuers are encouraged to participate in the Targeted Lending Initiative. There is no separate application procedure or pre-approval required. Once a Ginnie Mae issuer has originated or purchased eligible loans, the issuer merely has to indicate the reduced applicable guaranty fee with the pool submission in order to participate in the Targeted Lending Initiative. The Initiative has been effective for pools issued on or after October 1, 1996.

### **Ginnie Mae Targeted Lending Initiative: “Your Path to Homeownership” Mortgage Pre-qualification Software**

To further increase lending in central cities, Ginnie Mae has developed an easy-to-use mortgage prequalification software program (Path to Homeownership)



for prospective homeowners. The software application enhances consumer awareness of potential homeownership financing opportunities. The program is designed to serve as an educational tool as well as a pathfinder to community-based information resources or local counseling agencies. Potential borrowers can operate the computer program with readily available household financial information and the requirement of only the most basic computer skills. Based on the household income and debt provided, the software will calculate the potential borrower's eligibility for mortgage loans under either FHA or VA program guidelines.

### **Customer Satisfaction Survey**

During 1997, Ginnie Mae conducted a customer satisfaction survey of Ginnie Mae-approved single-family issuers. The first of its kind for Ginnie Mae, the comprehensive survey offered issuers the opportunity to provide feedback through over 80 questions and employed both "rating" and "short answer" question formats. With an effective response rate of 68 percent and responses from issuers in 42 states, Ginnie Mae received a tremendous amount of feedback from the issuer community.

The results of the survey indicated that the respondents had a high level of satisfaction with the

benefits of the Ginnie Mae program, the GinnieNET system, and the knowledge of Ginnie Mae Account Executives. Respondents were satisfied with the current designated response time of 48 hours from Account Executives, but believed that the required response could be shorter. Respondents believed improvements could be made in the fees charged for pool transfers, range of educational seminars offered by Ginnie Mae for the issuer community, the helpfulness of Ginnie Mae's current voice mail system, and Ginnie Mae's overall timeliness in responding to changes in the lending environment.

Ginnie Mae is continuing to analyze the feedback provided by the issuer community through this survey and has already begun several initiatives in response to the areas for improvement identified by survey participants.

### **Office of Finance Business Process Redesign**

Ginnie Mae faces new challenges due to its continued growth and the dynamics of its industry. To further address these challenges, Ginnie Mae analyzed the functions of the Office of Finance as part of a Business Process Reengineering (BPR) project that began in the last two months of fiscal year 1997, with recommendations finalized in December 1997.

This BPR effort reviewed the processes and procedures of the Office of Finance. This included analyzing functional responsibilities, processes, procedures, and internal control methodologies against best practices. The results of this assessment identified opportunities to streamline the process by increasing productivity, improving customer satisfaction, and reducing cycle time to perform Finance Activities. These proposed process improvements may be achieved through an integrated financial management system and changes to the current Finance business processes, such as redirecting goals from transaction and controls processing to financial analysis and reporting. The BPR effort helped Ginnie Mae's Office of Finance (Finance) to identify ways to achieve its goals of:

- Developing the operational capabilities of a world-class financial institution positioned for the 21st century;
- Ensuring that the Finance function is a credible partner and business advisor to Ginnie Mae organizations in the proactive management of financial resources, risk, profitability, and information;
- Extending focus from internal financial controls and transaction processing issues to include a customer service orientation in support of "external" strategic and competitive concerns; and,
- Promoting a working environment that practices open communication and teamwork and rewards self-improvement and efficiency gains.

### **Ginnie Mae Audits and Internal Controls**

The Ginnie Mae Office of Finance managed and coordinated audits and reviews of its contractors. During fiscal year 1997, Ginnie Mae's auditors completed 14 contract compliance audits and internal control reviews of its major contractors, and there were four in progress at year end.

These audits were conducted to determine if the contractors complied with the terms of their contracts

with Ginnie Mae. During these audits, verification was made that the bills were accurate and internal controls were reviewed to assure that the current operating environment minimizes risk to Ginnie Mae. Ginnie Mae conducts audits of its contractors regularly to ensure that identified weaknesses are resolved.

These periodic audits and reviews are an essential element of protecting, safeguarding, and improving its already strong MBS program by:

- Enhancing Ginnie Mae's ability to monitor its financial operations.
- Managing risk and protecting Ginnie Mae's assets.
- Strengthening internal controls.
- Strengthening financial management performance.

### **PROCESS, INFRASTRUCTURE AND TECHNOLOGY IMPROVEMENTS**

As part of our commitment to excellence in customer service, during fiscal year 1997, Ginnie Mae continued to build the infrastructure that will enable it to improve its services and communication to issuers and other program participants. After undertaking a systematic examination of operations,



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Ginnie Mae implemented numerous detailed process improvements to achieve specific desired outcomes. After completing its first round of “Opportunities for Improvement” in fiscal year 1996, Ginnie Mae continued to improve and streamline its operations in fiscal year 1997. The resulting efficiencies are providing substantial savings to the mortgage market. Ginnie Mae streamlined its processes and provided greater flexibility in its guidelines and regulations in order to meet its goals.

### New Processing Efficiencies

Some of the more notable improvements and processing efficiencies implemented in fiscal year 1997 include:

- The use of electronic signature technology, allowing issuers to issue securities in a paperless environment for certain pool types. As a result of this improvement, Ginnie Mae reduced pool processing time from four business days to two business days. Also, these and earlier improvements have enabled Ginnie Mae to eliminate a total of eight paper documents. This has resulted in an estimated cost savings of \$27 million annually in interest costs that issuers pay on warehouse lines, bringing estimated total savings over the last two years to \$112 million.
- Consolidation of Ginnie Mae and FHA’s processes for reviewing annual audited financial statements of program participants. Under this arrangement, Ginnie Mae has assumed the responsibility of performing the annual audited financial statement reviews of all institutions participating in both Ginnie Mae’s MBS program and FHA’s Title I and Title II programs. Previously, this function was performed separately by each organization. This effort has eliminated the need for issuers/mortgagees to file annual audited financial statements with both organizations and has streamlined the process for our customers.
- A reduction in pool processing time for

multifamily pools from ten business days to five business days saving an estimated \$4 million annually in warehousing interest cost.

- Reduction of our transfer fees for low balance pools (pools where the dollar amount of the outstanding remaining principal balance of the pool is ten percent or less of the pool’s original principal balance). This has resulted in an estimated cost savings of \$2.5 million.

### Organizational Structure

Beyond the process improvements, Ginnie Mae’s organizational structure enables Ginnie Mae to be effective in responding to change, to focus resources on mitigating and managing its business risks, to improve customer service to issuers, and to improve contractor oversight.

**The Office of Customer Service** continues to provide a valuable service for Ginnie Mae customers, and is dedicated to fulfilling its goal of providing a single point of contact with the issuer community. The Account Executives charged with achieving this goal are continually striving to assist our customers while maintaining the integrity of the overall Ginnie Mae mortgage-backed securities program. Also, Capital Markets customers have direct access to Ginnie Mae’s Capital Markets Division, where expertise in mortgage securities



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markets is available to support the value of Ginnie Mae securities. The Office of Customer Service stays abreast of the industry trends to better understand our customers' concerns and suggestions. It also promotes leading edge approaches to doing business in the dynamic secondary mortgage market. To that end, the Office of Customer Service was instrumental in promoting the highly successful Targeted Lending Initiative and participating in industry forums on how to conduct business more effectively and lower the financing costs to low- and moderate-income homebuyers.

Other initiatives introduced during 1997 include the introduction of several new products for the Ginnie Mae multiclass securities program, including Modifiable and Exchangeable REMIC Certificates, Re-REMICs, and Callable Trusts and Callable REMICs. The Office of Customer Service continued to encourage participation in the multiclass program by lowering fees involved in securitizing Platinum and REMIC securities.

**The Office of Multifamily Programs** serves as Ginnie Mae's single point of contact for issuers concerning their participation in Ginnie Mae's multifamily programs. The Office has responsibility from inception through termination in multifamily matters, ranging from approving issuers through disposition of defaulted assets.

**The Office of Program Administration** provides administrative support for the MBS programs. The Office oversees the processing of a variety of actions initiated by Ginnie Mae's customers. It also manages and directs the activities of several major contractors that provide support in operating Ginnie Mae's programs. The Office is also responsible for coordinating all Information Technology initiatives for Ginnie Mae through the auspices of Ginnie Mae's Chief Information Officer.

### **The Office of Policy, Planning, and Risk**

**Management** evaluates the effectiveness of Ginnie Mae's programs and products, assists in institutional policy formulation and product development, identifies business risks and develops controls and strategies for mitigating them, develops and tracks progress against strategic and annual business plans, and identifies staff development needs and training programs to meet those needs.

**The Office of Finance** maintains management and operational controls for Ginnie Mae, ensures compliance with the reporting requirements of the Federal Financial Managers' Integrity Act and the Chief Financial Officers Act, provides accounting and financial reporting services, manages the investment of Ginnie Mae funds, prepares and monitors the execution of Ginnie Mae's budget, and oversees the management of acquired defaulted assets. The Office of Finance also coordinates the audit of Ginnie Mae, minimizes financial risk, maintains necessary internal controls, and manages and coordinates field audits and reviews of master subservicers and major contractors to minimize risk to Ginnie Mae. In addition to financial management and operational controls, the Office of Finance provides assistance for automated financial management systems development efforts for Ginnie Mae.



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## Technology Improvements

During fiscal year 1997, Ginnie Mae continued to build upon previous technology improvements that have enabled it to further reduce paperwork and provide more efficient processes that have benefited customers and Ginnie Mae. Below are some of the notable improvements that took place in fiscal year 1997:

### *GinnieNET Electronic Signature Technology*

Ginnie Mae made enhancements to its GinnieNET pool processing software (pool delivery system) that uses electronic signature technology. Issuers are now able to delete and re-submit pools within one business day after their document custodian has certified the pools. To support the Targeted Lending Initiative, the software was enhanced to enable issuers to automatically verify whether a loan or pool is in a targeted area and calculate the appropriate Ginnie Mae guarantee fee.

### *Electronic Data Interchange (EDI)*

Ginnie Mae's Electronic Data Interchange (EDI) Program is well under way. Following a successful pilot, Ginnie Mae has embarked on its implementation of the American National Standards Institute's Secondary Mortgage Market Investor Report. Participants in the Ginnie Mae EDI program will experience a number of benefits, some of which are listed below:

- Quicker feedback on submission status and results;
- Improved ability to identify errors in data prior to submission;
- Decreased mail costs;
- Reduced paper and physical media processing; and,

- Increased efficiencies based on the use of the same transaction set for investor reporting with Ginnie Mae, the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac).

Ginnie Mae expects that all participants in its EDI program will benefit from implementing EDI, and looks forward to including every member of its issuer community in the EDI program.

Ginnie Mae completed a successful pilot program for receiving quarterly loan level data via EDI using the American National Standards Institute's Secondary Mortgage Market Investor Report. This application is now available for all program participants. Currently, over thirty percent of all loans backing Ginnie Mae securities are reported through this means. Ginnie Mae expects that all participants using this application will benefit. Some of the advantages include the ability to:

- Transmit the same standardized data format to all government trading partners;
- Receive faster feedback from Ginnie Mae about the success of loan processing submissions; and,
- Receive information from Ginnie Mae about problems with the reported data in time to correct it for the next quarterly cycle.

### *Ginnie Mae Business Center*

In fiscal year 1996 Ginnie Mae established the Ginnie Mae Business Center (Center), which is a major cornerstone in Ginnie Mae's efforts to:

- Take full advantage of technology to provide more efficient loan securitization which will ultimately increase affordable housing in America;
- Provide the necessary tools and setting to conduct Joint Application Development (JAD) sessions with our partners; and,



- Improve operational controls by taking ownership of certain system applications that were owned by private contractors.

Through the use of the Center, Ginnie Mae accomplished the following in fiscal year 1997:

- Conducted JAD sessions with issuers and document custodians on various automation projects (e.g., EDI and GinnieNET.)
- Piloted and implemented Ginnie Mae's EDI process for Quarterly Loan Level information. Already more than 130 issuers are submitting their loan level data via EDI. The EDI application is housed at the Center. Other Ginnie Mae issuers are being encouraged to convert to EDI.
- Provided GinnieNET training for issuers and document custodians on latest up-dates to Ginnie Mae's electronic pool delivery system. With the addition of electronic signature technology, we are now able to process pools in a paperless environment. Processing time for paperless pools has been reduced from four to two business days, making the process more efficient and reducing issuers' warehousing cost.
- Relocated Ginnie Mae's Independent Public

Accountant system to the Center where it now resides on a platform that enables Ginnie Mae to provide FHA personnel with access to issuers' / mortgagees' audited financial data. Ginnie Mae performs the financial statement reviews for lenders that have both FHA mortgagee and Ginnie Mae issuer status.

### *World Wide Web Site*

The Ginnie Mae World Wide Web site provides a valuable information and communication tool.

One of the driving factors behind the Internet, and perhaps the most exciting aspect of the Internet today, is the World Wide Web (Web). Essentially, the Web is an innovative way of organizing and presenting files, and providing search capabilities for information on the Internet. The popularity of the Web as an information-providing tool has made it a necessary communication channel for both commercial and government entities. For this reason, and as part of our ongoing effort to continuously improve our customer service, Ginnie Mae established a presence on the World Wide Web in fiscal year 1997. Ginnie Mae's Web site:

- Provides a user-friendly point-of-access to program information, industry news, frequently-asked questions, links to related finance and capital markets industry sites, and e-mail links to Ginnie Mae. Our Web site is proving to be a critical connection between Ginnie Mae and our issuer, investor, and borrower communities, as well as other stakeholders who communicate with Ginnie Mae.
- Launches on-line versions of policy compliance guides (known as "Guide I" and "Guide II"), and our All Participants Memos (APMs) - the guides and APMs are already the most frequently visited features of the site!

- Supports the Targeted Lending Initiative by allowing users to determine whether a specific Address or Census Tract ID falls within a Targeted Lending area.
- Provides customers and stakeholders, as part of our commitment to customer service, with instant access to continually updated information about our programs, products, and services.
- Includes telephone and e-mail “hotlines” as support mechanisms for our web site visitors. All calls and messages are tracked to help Ginnie Mae continuously improve customer service. Our telephone hotline is 1-888-GINNIE4, and our e-mail hotline can be accessed through the Web site.

Ginnie Mae continuously enhances the content, functionality, and appearance of our Web site, and we invite visitors to browse the site and provide feedback and comments about what they find there. The web site address is:

<http://www.ginniemae.gov>

## RISK MANAGEMENT

Ginnie Mae continues to enhance its automated systems and business processes to increase the efficiency of its operations and to reduce its business risk.

During fiscal year 1997, Ginnie Mae continued periodic reviews of all master subservicers to assure compliance with the terms and conditions of their servicing contracts with Ginnie Mae.

As a direct result of these reviews, improvements in accounting and statistical reports prepared by the master subservicers have been achieved, aiding Ginnie Mae in the management and liquidation of

defaulted portfolios. Additionally, in fiscal year 1997, major Ginnie Mae contractors were reviewed for contract compliance. The audits and reviews provided Ginnie Mae with a mechanism for continuing to strengthen its internal controls and to minimize risks.

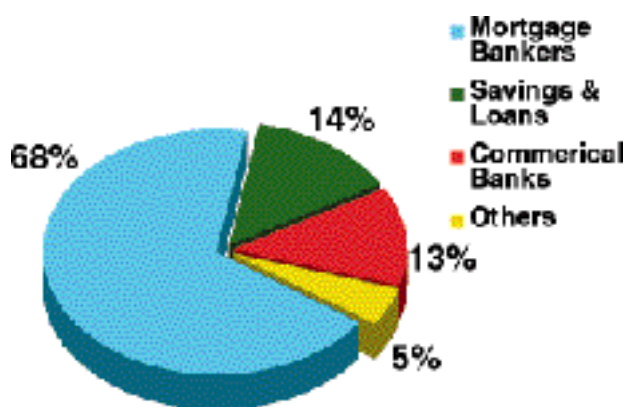
## COMPLIANCE WITH THE CFO ACT

Ginnie Mae has prepared a separate management report in compliance with the Chief Financial Officers Act of 1990 that contains more detailed information. It is available upon request from the Ginnie Mae Office of Finance at 202/401-2064.

## PROGRAM ACTIVITIES

Ginnie Mae issued \$98.9 billion in commitment authority in fiscal year 1997, a 10 percent decrease from fiscal year 1996. Ginnie Mae guaranteed \$97.6 billion of MBSs during fiscal 1997, representing a decrease of 4 percent from the prior year due to a lag in securitization to market.

Of the \$97.6 billion of MBSs guaranteed, over \$95 billion was backed by single-family mortgages, \$3



**MBS Program Participants**

billion by multifamily construction and project loans, and \$27 million by manufactured housing loans. One of Ginnie Mae's performance measures is to maintain a 95 percent securitization rate of FHA and VA loans. In fiscal year 1997, Ginnie Mae securitized 98 percent of FHA and VA loans.

Delinquency ratios for the MBS pooled mortgages declined in the multifamily and manufactured housing programs when compared to the previous fiscal year, while delinquencies in the single-family program remained the same. Ginnie Mae will continue to monitor issuers through the Issuer Portfolio Analysis Database System for unusual fluctuations in portfolio delinquency rates. From fiscal year 1996 to fiscal year 1997, the three-month delinquency rate in the single-family program increased from 1.96 percent to 1.97 percent, demonstrating a level consistent with delinquency ratios in past fiscal years. The three-month delinquency rate in the manufactured housing program decreased from 5.31 percent to 4.64 percent. The two-month delinquency rate in the multifamily program decreased from 1.44 percent to 0.92 percent.

### Single-Family and Manufactured Housing Programs

Ginnie Mae works to ensure that the servicing of loans collateralizing MBSs is properly performed

and that payment of principal and interest to security holders is made in a timely manner.

During fiscal year 1997, Ginnie Mae acquired four single-family portfolios with an aggregate principal balance of \$350.6 million, representing a \$290.9 million increase from the \$59.7 million acquired in fiscal year 1996. The multifamily and manufactured housing programs experienced no defaults in fiscal year 1997.

By the end of fiscal year 1997, Ginnie Mae had an acquired servicing portfolio of \$827 million, an increase of 21 percent from fiscal year 1996. This \$141 million increase was due to the acquisition of four single-family portfolios that Ginnie Mae experienced offset by normal amortization of principal. The single-family acquired portfolio increased 92 percent to \$606.7 million as of September 30, 1997. Overall, the single-family acquired portfolio represents 0.12 percent of the total single-family RPB outstanding for the Ginnie Mae MBS program, an increase of 0.05 percent from fiscal year 1996.

The manufactured housing acquired portfolio experienced a 34 percent decrease during the year to \$220.3 million at September 30, 1997. The decrease was primarily a result of normal program operations and other liquidations. Overall, the manufactured

**Annual Defaulted Unpaid Principal Balance  
By Portfolio Five-Year History**  
(In Millions of Dollars)

Portfolio	1997	1996	1995	1994	1993
Single-Family	\$351	\$60	\$202	\$86	\$286
Multifamily	0	0	237	32	0
Manufactured Housing	0	0	0	0	256
Total	\$351	\$60	\$439	\$118	\$542

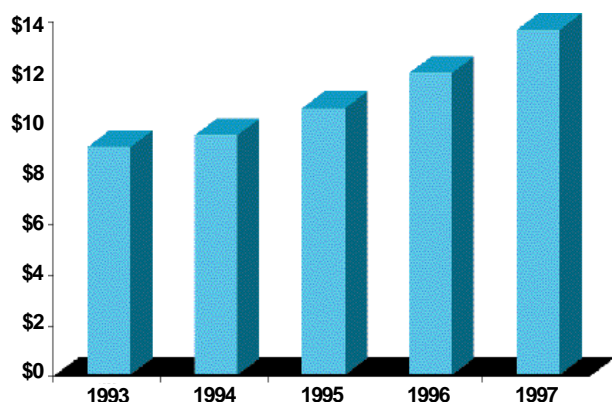
housing acquired portfolio represents 16 percent of the total manufactured housing RPB outstanding, a decrease of 19 percent from fiscal year 1996.

## Multifamily Mortgage-Backed Security Programs

Since the inception of the Multifamily MBS Program, Ginnie Mae has guaranteed the issuance of approximately \$28 billion in multifamily securities.

Ginnie Mae's Multifamily Mortgage-Backed Security Programs experienced a banner year in fiscal year 1997. Issuances of securities were up, delinquencies were down and defaults of issuers were non-existent.

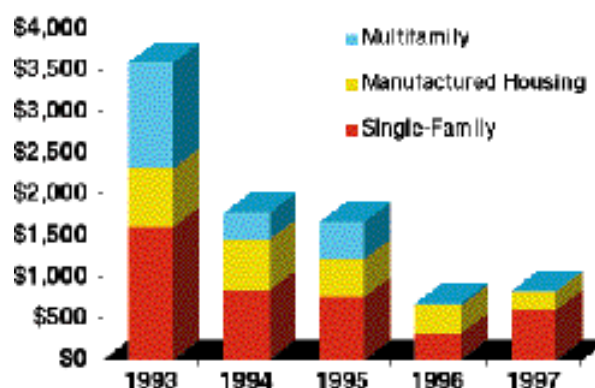
Outstanding securities in the Multifamily Programs



**Multifamily MBS Outstanding**  
(dollars in billions)

increased again by over 14 percent to a record \$13.6 billion. This was a result of the issuance of \$2.5 billion in securities for fiscal year 1997. Commitments issued for Multifamily Securities also increased from the previous year by 33 percent to \$3 billion.

The ratio of delinquent multifamily loans in Ginnie Mae multifamily pools decreased to 0.92 percent from 1.44 percent the previous year, a 36 percent decline. Also, for the third consecutive year Ginnie Mae experienced no multifamily issuer defaults. By year end, Ginnie Mae had liquidated the remaining balance of its acquired multifamily portfolio.



**Management of Defaulted Portfolio**  
(dollars in millions)

With increased promotion of the Multifamily Programs of Ginnie Mae, the percentage of FHA multifamily loans securitized increased from 54 percent in fiscal year 1996 to 81 percent in fiscal year 1997. This is up from just 20 percent a mere four years ago. The number of issuers participating in the Multifamily Programs increased by 10 percent during fiscal year 1997.

Ginnie Mae introduced two new Multifamily Program pool types during the year. Small Loan Pools and Mature Loan Pools became effective on April 1, 1997. The Small Loan Program allows for the securitization of small FHA-insured loans on a streamlined basis. The Mature Loan Program provides, for the first time, a secondary market for loans older than 24 months.

Finally, Ginnie Mae reduced the Multifamily Pool processing time for the issuance of new pools from ten business days to five business days during the fiscal year. This was accomplished by streamlining the process and eliminating pooling documents that did not add value to the review process.

### **Ginnie Mae Multiclass Program**

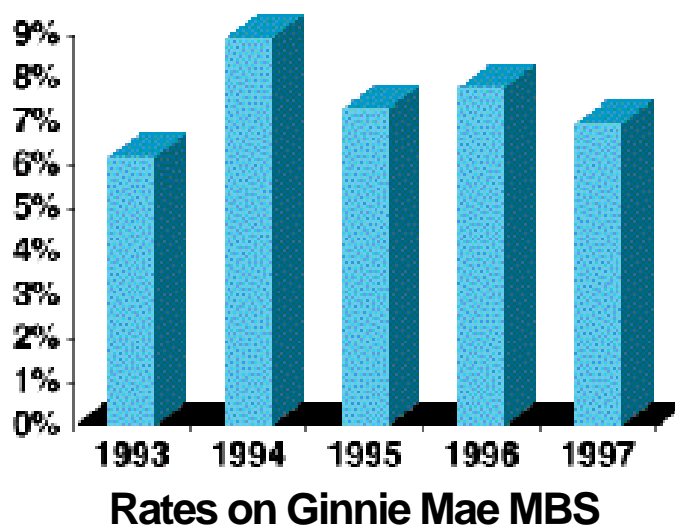
During 1997, Ginnie Mae built on its successful multiclass securities program to continue its initiatives that support the value of the Ginnie Mae MBS. As part of Ginnie Mae's Office of Customer Service, the Capital Markets Division gives Ginnie Mae customers direct access to expertise in the mortgage securities markets and disclosure data necessary for Ginnie Mae investors.

During fiscal year 1997, Ginnie Mae guaranteed \$7 billion in REMIC securities resulting in \$2.8 million in fees to Ginnie Mae. Ginnie Mae also guaranteed \$20.8 billion in Ginnie Mae Platinum securities, generating \$13.8 million in fees, a portion of which are reserved for future expenses.

Ginnie Mae's REMIC securities give investors the

ability to customize MBS securities to their individual requirements. Ginnie Mae Platinum Securities permit the combination of smaller, less liquid MBS pools into fewer, larger Ginnie Mae MBSs. The conversion reduces the administrative costs of holding MBS. Multiclass securities improve the pricing of Ginnie Mae MBS. Improved MBS pricing, in turn, reduces interest rates for low- and moderate-income homeowners.

The commencement of the Ginnie Mae REMIC and Platinum programs has resulted in increased liquidity of mortgage funds. Although many economic factors are involved in the change in the supply of mortgage funds, the Ginnie Mae REMIC and Platinum securities have played a role in increasing the availability of mortgage funds to low- and moderate-income and first-time home buyers. Ginnie Mae will continue product innovation, program enhancements, investor education, and competitive pricing to ensure that the increased liquidity and efficiencies gained in the capital markets by the multiclass securities program are maintained. The actions are ongoing and provide for the continued accrual of the benefit from the multiclass securities program to mortgagors.



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## VIEW OF THE FUTURE

During fiscal year 1997, Ginnie Mae helped increase homeownership levels in urban areas through such programs as its successful Targeted Lending Initiative.

Ginnie Mae also implemented policies and procedures to improve program efficiency and to better serve its customers. Through new product offerings and reduction in securitization fees, Ginnie Mae continually strives to make its program attractive to investors in the capital markets. Additionally, Ginnie Mae continues to make organizational improvements in its business by internal and external review of its operations and by

operating as a customer service driven organization. These efforts will continue to strengthen Ginnie Mae's financial position and ensure its ability to meet its mission.

In fiscal year 1998, as well as into the 21st Century, process and product improvements, through the incorporation of technology and providing greater service to our clients, will remain a management priority. Ginnie Mae will endeavor to face the challenges of the future with confidence and innovative solutions and products, while striving to serve its vital historic role in the provision of mortgage credit for low- and moderate-income American families.



<http://www.ginniemae.gov>





2001 M Street, NW  
Washington, DC 20036

## **INDEPENDENT AUDITORS' REPORT**

To the Inspector General,  
U.S. Department of Housing and Urban Development:

We have audited the 1997 and 1996 financial statements of the Government National Mortgage Association (Ginnie Mae). The objective of our audits was to express an opinion on the fair presentation of Ginnie Mae's financial statements based on our audits. In connection with our audits we also considered Ginnie Mae's internal control and tested Ginnie Mae's compliance with provisions of applicable laws and regulations that could have a direct and material effect on its financial statements.

In our opinion, Ginnie Mae's 1997 and 1996 financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles.

We noted no matters involving internal control and its operations that we consider to be material weaknesses.

The results of our tests of compliance disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* and Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*, as amended.

Our opinion on Ginnie Mae's financial statements, our consideration of internal control, our tests of Ginnie Mae's compliance with certain laws and regulations and our responsibilities are discussed in the remainder of our report.

## **OPINION ON FINANCIAL STATEMENTS**

We have audited the accompanying balance sheets of Ginnie Mae, as of September 30, 1997 and 1996, and the related statements of revenues and expenses and changes in investment of U.S. government and cash flows for the years then ended. These financial statements are the responsibility of Ginnie Mae's management. Our responsibility is to express an opinion on these financial statements based on our audits.

In our opinion, the accompanying 1997 and 1996 financial statements present fairly, in all material respects, the financial position of Ginnie Mae as of September 30, 1997 and 1996, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

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The Office of Inspector General (OIG) is required to conduct an annual audit of Ginnie Mae under the provisions of the Chief Financial Officers (CFO) Act of 1990. To fulfill that responsibility, OIG contracted with the independent certified public accounting firm of KPMG Peat Marwick LLP to conduct the audit for the year ended September 30, 1997. The complete OIG report (98-FO-171-0002) is included in the separate management report Ginnie Mae prepared pursuant to the CFO Act which is available upon request from Ginnie Mae.

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## INTERNAL CONTROLS

We noted no matters involving internal control and its operation that we consider to be material weaknesses or reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB Bulletin No. 93-06, as amended.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements of Ginnie Mae may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal controls that, in our judgment, could adversely affect Ginnie Mae's ability to ensure that the objectives of the internal controls, as defined, are being achieved.

Our consideration of internal control would not necessarily disclose all internal control matters that might be reportable conditions, and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses, as described above.

Although not considered material weaknesses, we noted other matters during our audit which have been reported to Ginnie Mae's management in a separate letter.

## COMPLIANCE WITH LAWS AND REGULATIONS

The results of our tests, performed as part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* and OMB Bulletin No. 93-06, as amended.

## RESPONSIBILITIES

**Management's Responsibility.** The Chief Financial Officers (CFO) Act of 1990 requires federal agencies to report annually to Congress on their financial status and any other information needed to fairly present the agencies' financial position and results of operations. To meet the CFO Act reporting requirements, Ginnie Mae prepares annual financial statements. Ginnie Mae is an agency operated by the U.S. Department of Housing and Urban Development (HUD).

Management has the responsibility for:

- preparing the financial statements in conformity with generally accepted accounting principles;
- establishing and maintaining internal controls; and
- complying with applicable laws and regulations.

In fulfilling these responsibilities, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that:

- 
- transactions are executed in accordance with management's authorization and are properly recorded and accounted for to permit the preparation of reliable financial statements in conformity with generally accepted accounting principles, and to maintain accountability over assets;
  - funds, property, and other assets are safeguarded from unauthorized use or disposition; and
  - transactions, including those related to obligations and costs, are executed in compliance with laws and regulations that could have a direct and material effect on the financial statements.

**Auditors' Responsibility.** Our responsibility is to express an opinion on the 1997 and 1996 financial statements of Ginnie Mae based on our audits. We conducted our audits in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 93-06, as amended, except for those portions of the Bulletin that relate to the review of performance measures. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement and presented fairly in accordance with generally accepted accounting principles. We believe that our audits provide a reasonable basis for our opinion. Our audits were not designed to test the requirements of OMB Bulletin No. 93-06, as amended, relating to the *Federal Financial Management Improvement Act* (FFMIA), as FFMIA is not considered applicable at the Ginnie Mae level. FFMIA requirements will be reviewed and reported on at the HUD consolidated level.

In planning and performing our audit of the financial statements of Ginnie Mae, we considered internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on internal control over financial reporting. Accordingly, we do not express such an opinion.

As part of obtaining reasonable assurance about whether Ginnie Mae's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations. However, providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

In order to fulfill these responsibilities, we:

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall financial statement presentation; and
- tested compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 93-06, as amended.

With respect to internal control, we obtained an understanding of the design of relevant policies and procedures, determined if they had been placed in operation, assessed control risk, and performed tests of internal controls.

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Because of inherent limitations of internal control, fraud may nevertheless occur and not be detected. Also, projection of an evaluation of internal controls to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

This report is intended solely for the use of the HUD Office of the Inspector General, the management of HUD and Ginnie Mae, and Congress. However, this report is a matter of public record and its distribution is not limited.

February 12, 1998  
Washington, D.C.

**GOVERNMENT NATIONAL MORTGAGE ASSOCIATION**

**BALANCE SHEETS**

	September 30, <u>1997</u>	<u>1996</u>
	(In thousands)	
<hr/>		
<b>Assets:</b>		
Funds in U.S. Treasury . . . . .	\$ 155,800	\$ 131,200
U.S. Government securities-Note B . . . . .	5,382,000	4,785,100
Mortgages held for sale, net-Note C . . . . .	3,800	1,200
Properties held for sale, net-Note D . . . . .	3,000	5,600
Accrued interest and other receivables . . . . .	101,700	83,900
Advances against defaulted Mortgage- Backed Security pools, net-Note E . . . . .	29,100	29,500
Claims against HUD/FHA and VA . . . . .	<u>7,500</u>	<u>5,900</u>
	<u><b>\$ 5,682,900</b></u>	<u><b>\$ 5,042,400</b></u>
<b>Liabilities and Investment of U.S. Government</b>		
<b>Liabilities:</b>		
Reserve for loss on Mortgage-Backed Securities Program-Note F . . . . .	\$ 507,700	\$ 471,700
Deferred revenue . . . . .	19,200	14,800
Deferred liabilities/deposits . . . . .	1,700	1,800
Accounts payable and accrued liabilities . . . . .	<u>19,700</u>	<u>20,700</u>
	<b>\$ 548,300</b>	<b>\$ 509,000</b>
<b>Commitments and Contingencies-Note I</b>		
Investment of U.S. Government . . . . .	<u><b>5,134,600</b></u>	<u><b>4,533,400</b></u>
	<u><b>\$ 5,682,900</b></u>	<u><b>\$5,042,400</b></u>

See accompanying notes to financial statements.

# GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

## STATEMENTS OF REVENUES AND EXPENSES AND CHANGES IN INVESTMENT OF U.S. GOVERNMENT

Year ended September 30,  
1997 1996  
(In thousands)

### Revenues:

Mortgage-Backed Securities Program income .....	\$ 353,800	\$ 335,200
Interest income .....	318,200	274,100
Other income, net .....	<u>14,700</u>	<u>11,700</u>
<b>Total Revenues .....</b>	<b>686,700</b>	<b>621,000</b>

### Expenses:

Mortgage-Backed Securities Program expenses .....	29,400	27,100
Administrative and other expenses .....	<u>9,300</u>	<u>9,100</u>
<b>Total Expenses .....</b>	<b>38,700</b>	<b>36,200</b>

Provision for loss on Mortgage-Backed Securities Program-Note F .....	<u>46,800</u>	<u>69,300</u>
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<b>Excess of Revenues Over Expenses .....</b>	<b><u>601,200</u></b>	<b><u>515,500</u></b>
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### Investment of U.S. Government at Beginning

<b>of Year .....</b>	<b>4,533,400</b>	<b>4,033,300</b>
Excess of revenues over expenses .....	601,200	515,500
Returned to U.S. Treasury .....	<u>0</u>	<u>(15,400)</u>

### Investment of U.S. Government at End of

<b>Year .....</b>	<b><u>\$ 5,134,600</u></b>	<b><u>\$ 4,533,400</u></b>
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See accompanying notes to financial statements.

# GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

## STATEMENTS OF CASH FLOWS INCREASE (DECREASE) IN CASH

Year ended September 30,  
1997 1996  
(In thousands)

### Cash flows from operating activities:

Interest received . . . . .	\$ 301,800	\$ 279,400
Mortgage-Backed Securities Program fees . . . . .	352,400	333,600
Advances against defaulted Mortgage-Backed Security pools . . . . .	(5,100)	(6,800)
Mortgage-Backed Securities Program losses and expenses . . . . .	(36,300)	(30,900)
Other income received . . . . .	23,300	20,000
Administrative expenses . . . . .	(9,300)	(9,100)
Purchases of mortgages/properties, net of disposal . . . . .	(15,900)	(1,200)
Recoveries from FHA and VA . . . . .	10,600	5,500

<b>Net cash provided by operating activities . . . . .</b>	<b><u>621,500</u></b>	<b><u>590,500</u></b>
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### Cash flows from investing activities:

Purchase of U.S. Treasury Securities, net . . . . .	<u>(596,900)</u>	<u>(536,500)</u>
<b>Net cash used by investing activities . . . . .</b>	<b><u>(596,900)</u></b>	<b><u>(536,500)</u></b>

### Cash flows from financing activities:

Cash returned to U.S. Treasury . . . . .	<u>0</u>	<u>(15,400)</u>
<b>Net cash used by financing activities . . . . .</b>	<b><u>0</u></b>	<b><u>(15,400)</u></b>

<b>Net increase in cash . . . . .</b>	<b>24,600</b>	<b>38,600</b>
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<b>Funds in US Treasury at beginning of year . . . . .</b>	<b><u>131,200</u></b>	<b><u>92,600</u></b>
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<b>Funds in US Treasury at end of year . . . . .</b>	<b><u>\$ 155,800</u></b>	<b><u>\$ 131,200</u></b>
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See accompanying notes to financial statements.

**GOVERNMENT NATIONAL MORTGAGE ASSOCIATION**

**STATEMENTS OF CASH FLOWS - RECONCILIATION OF NET EXCESS OF REVENUES  
OVER EXPENSES TO NET CASH PROVIDED BY OPERATING ACTIVITIES**

Year ended September 30,  
1997                      1996  
(In thousands)

<b>Net excess of revenue over expenses . . . . .</b>	<b>\$ 601,200</b>	<b>\$ 515,500</b>
<b>Adjustments to reconcile net excess of revenue over expenses to net cash provided by operating activities:</b>		
Provision for loss on Mortgage-Backed Securities Program . . . . .	46,800	69,300
(Increase) decrease in accrued interest and other receivables . . . . .	(16,400)	5,200
Decrease in advances against defaulted Mortgage-Backed Security pools . . . . .	400	48,900
Decrease in deposit liabilities . . . . .	(100)	(8,000)
(Decrease) increase in accounts payable and accrued liabilities . . . . .	(1,000)	1,600
Increase in deferred revenue . . . . .	4,400	4,200
Decrease in Mortgage-Backed Securities reserve relating to operating activities . . . . .	<u>(13,800)</u>	<u>(46,200)</u>
<b>Total adjustments . . . . .</b>	<b><u>20,300</u></b>	<b><u>75,000</u></b>
<b>Net cash provided by operating activities . . . . .</b>	<b><u>\$ 621,500</u></b>	<b><u>\$ 590,500</u></b>

See accompanying notes to financial statements.

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## GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

### NOTES TO THE FINANCIAL STATEMENTS

#### NOTE A--ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Government National Mortgage Association (Ginnie Mae) was created in 1968 through amendment of Title III of the National Housing Act as a Government corporation within the Department of Housing and Urban Development (HUD).

The mortgage-backed securities (MBS) program is Ginnie Mae's primary ongoing activity. The purpose of the program is to increase liquidity in the secondary mortgage market and attract new sources of capital for residential loans. Through the program, Ginnie Mae guarantees the timely payment of principal and interest on securities backed by pools of mortgages issued by private mortgage institutions. The guaranty is backed by the full faith and credit of the United States Government. Ginnie Mae requires that the mortgages be insured or guaranteed by the Federal Housing Administration (FHA), the Rural Housing Service (RHS), (formerly Farmer's Home Administration), or the Department of Veterans Affairs (VA).

These MBS securities are not assets of Ginnie Mae, nor are the related outstanding securities liabilities; accordingly, neither is reflected on the accompanying balance sheets.

**Funds in U.S. Treasury:** All of Ginnie Mae's receipts and disbursements are processed by the U.S. Treasury which, in effect, maintains Ginnie Mae's bank accounts. For purposes of the Statement of Cash Flows, Funds in U.S. Treasury are considered cash.

**U.S. Government Securities:** Ginnie Mae classifies its investments in U.S. Government Securities based on its ability and positive intent to hold them to maturity. Therefore, Ginnie Mae's investment in U.S. Government securities is recorded at amortized cost. Discounts and premiums are amortized over the life of the related security.

**Mortgage Loans Held for Sale:** Mortgage loans held for sale are carried at the lower of cost or fair value, with any unrealized losses included in current period earnings. The related allowance for loss is established to reduce the carrying value of mortgages held for sale to their estimated fair value which is based on the amount Ginnie Mae expects to realize in cash upon sale of the mortgages.

**Properties Held for Sale:** Foreclosed assets are recorded at the lower of cost or fair value less estimated costs to sell. The related allowance for loss is established to reduce the property carrying value to fair value less costs to sell. Property related expenses incurred during the holding period are included in Mortgage-Backed Securities program expenses.

**Advances Against Defaulted Mortgage-Backed Security Pools:** Advances against defaulted mortgage-backed security pools represent payments made to fulfill Ginnie Mae's guaranty of timely principal and interest payment to the MBS security holders. Such advances are reported net of an allowance for doubtful recoveries to the extent management believes they will not be recovered. The allowance for doubtful recoveries is estimated based on actual and expected recovery experience and is adjusted for FHA, VA and RHS claims that have been filed.

**Reserve for Loss on MBS Program:** In the operation of its MBS programs, Ginnie Mae estimates the present value cost of liquidating its existing portfolio of mortgage servicing rights acquired from

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defaulted issuers and expected future issuer defaults. Reserves are established to the extent management believes issuer defaults are probable and FHA, VA and RHS insurance or guarantees are insufficient to recoup Ginnie Mae expenditures. The reserves are increased by provisions charged as an expense in the Statements of Revenues and Expenses and reduced by charge-offs, net of recoveries.

**Recognition of Revenues and Expenses:** Ginnie Mae receives monthly guarantee fees for each MBS mortgage pool based on a percentage of the pool's outstanding balance. Fees received for Ginnie Mae's guaranty of mortgage-backed securities are recognized as earned. Fees received for commitments to guaranty mortgage-backed securities are recognized when the commitments are granted. Ginnie Mae recognizes as other income, net, the major portion of fees related to the issuance of multiclass securities in the period the fees are received, with the balance deferred and amortized as other income, net, over the weighted averaged life of the related mortgages to match the recognition of related administrative expenses. Losses on assets acquired through liquidation and claims against HUD/FHA and VA are recognized when they occur.

**Use of Estimates:** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**New Accounting Pronouncements:** The Federal Accounting Standards Advisory Board has issued the following pronouncements that become effective in the fiscal year ending September 30, 1998: Statements of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards*; SFFAS No. 6, *Accounting for Property, Plant and Equipment*; and SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. SFFAS No. 4 requires tracking and reporting of costs that correspond to outputs of business objectives. SFFAS No. 6 provides disclosure requirements for property, plant and equipment acquired from other Federal entities. SFFAS No. 7 requires disclosures related to budgetary resources and custodial activity. Management believes that the adoption of SFFAS Nos. 4, 6 and 7 will not have a material effect on Ginnie Mae's reported results of operations or financial position.

## NOTE B--U.S. GOVERNMENT SECURITIES

The U.S. Government Securities portfolio is held in special market based U.S. Treasury securities that are bought and sold at composite prices received from the Federal Reserve Bank of New York. These securities are maintained in book entry form at the Bureau of Public Debt. The coupon rates of Ginnie Mae's current holdings range from 5.0 percent to 8.0 percent. The amortized cost and fair values as of September 30, 1997 were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury Overnight Certificates	\$ 217,800	\$ 0	\$ 0	\$ 217,800
U.S. Treasury Notes	5,164,200	87,600	24,100	5,227,700
	<u>\$ 5,382,000</u>	<u>\$ 87,600</u>	<u>\$ 24,100</u>	<u>\$ 5,445,500</u>

The amortized cost and fair values as of September 30, 1996 were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury Overnight Certificates	\$ 507,100	\$ 0	\$ 0	\$ 507,100
U.S. Treasury Notes	4,278,000	35,400	72,400	4,241,000
	<u>\$ 4,785,100</u>	<u>\$ 35,400</u>	<u>\$ 72,400</u>	<u>\$ 4,748,100</u>

The amortized cost, fair value and annual weighted average interest rates of debt securities at September 30, 1997, by contractual maturity date, are as follows (dollars in thousands):

<u>Maturity</u>	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Weighted Average Interest Rate</u>
Due within one year	\$ 498,000	\$ 497,300	5.72%
Due after one year through five years	2,536,900	2,549,700	5.88%
Due after five years through ten years	2,347,100	2,398,500	6.13%
	<u>\$ 5,382,000</u>	<u>\$ 5,445,500</u>	5.98%

The amortized cost, fair value and annual weighted average interest rates of debt securities at September 30, 1996, by contractual maturity date, were as follows (dollars in thousands):

<u>Maturity</u>	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Weighted Average Interest Rate</u>
Due within one year	\$ 879,700	\$ 879,400	5.59%
Due after one year through five years	1,959,700	1,938,300	6.26%
Due after five years through ten years	1,945,700	1,930,400	6.65%
	<u>\$ 4,785,100</u>	<u>\$ 4,748,100</u>	6.29%

#### **NOTE C--MORTGAGES HELD FOR SALE, NET**

Ginnie Mae acquires certain mortgages from defaulted issuers' portfolios to bring the pools into conformity with MBS requirements. Mortgages ineligible to remain in pools when servicing-rights are sold are acquired by Ginnie Mae. Mortgages held for sale were as follows (in thousands):

	September 30,	
	<u>1997</u>	<u>1996</u>
Unpaid principal balance	\$ 7,000	\$ 2,300
Allowance for doubtful recoveries	<u>(3,200)</u>	<u>(1,100)</u>
Mortgages held for sale, net	<u>\$ 3,800</u>	<u>\$ 1,200</u>

#### **NOTE D--PROPERTIES HELD FOR SALE, NET**

Ginnie Mae acquires residential properties by foreclosure out of the defaulted issuer portfolios in order to comply with MBS requirements. Balances and activity in the properties held for sale were as follows (in thousands):

	September 30,	
	<u>1997</u>	<u>1996</u>
Cost of properties, beginning of year	\$ 8,100	\$ 6,500
Additions	23,000	20,100
Dispositions and losses	<u>(26,400)</u>	<u>(18,500)</u>
Cost of properties, end of year	4,700	8,100
Allowance for doubtful recoveries	<u>(1,700)</u>	<u>(2,500)</u>
Properties held for sale, net	<u>\$ 3,000</u>	<u>\$ 5,600</u>

## NOTE E--ADVANCES AGAINST DEFAULTED MORTGAGE-BACKED SECURITY POOLS

Under its MBS guaranty, Ginnie Mae advanced \$93.0 million in 1997 and \$128.6 million in 1996 against defaulted mortgage-backed security pools to ensure timely pass-through payments. Recoveries of advances, either from late payment remittances or through FHA insurance or VA guaranty proceeds, were \$84.4 million in 1997 and \$128.3 million in 1996. Advances of \$2.9 million were written off in 1997; there were \$.4 million of write-offs in 1996.

Unrecovered advances outstanding against defaulted mortgage-backed security pools, net of allowance for doubtful recoveries, were as follows (in thousands):

	September 30,	
	1997	1996
Advances against defaulted pools	\$ 324,500	\$ 318,800
Allowance for doubtful recoveries	(295,400)	(289,300)
Advances against defaulted pools, net	<u>\$ 29,100</u>	<u>\$ 29,500</u>

## NOTE F--RESERVE FOR LOSS ON MBS PROGRAM

Ginnie Mae establishes a reserve for losses through a provision charged to operations when, in management's judgment, defaults of issuers of mortgage-backed securities become probable. The allowance for losses is based on an analysis of the MBS portfolio outstanding. In estimating losses, management utilizes a statistically based model that evaluates numerous factors, including, but not limited to, general and regional economic conditions, mortgage characteristics, and actual and expected future default and loan loss experience. Management also considers uncertainties related to estimations in the reserve setting process. The reserve is relieved as losses are realized from the disposal of the defaulted issuers' portfolios. Ginnie Mae recovers part of its losses through servicing fees on the performing portion of the portfolios and the sale of servicing rights which inure to Ginnie Mae upon the default of the issuer. Ginnie Mae management believes that its reserve is adequate to cover probable losses from defaults by issuers of Ginnie Mae guaranteed mortgage-backed securities. Changes in the reserve were as follows (in thousands):

	Single-Family	Multifamily	Manufactured Housing	Total
September 30, 1995	\$ 150,000	\$ 40,800	\$ 265,000	\$ 455,800
Recoveries	7,600	1,100	13,600	22,300
Realized Losses	(4,700)	(44,500)	(26,500)	(75,700)
Provision	<u>(2,900)</u>	<u>59,300</u>	<u>12,900</u>	<u>69,300</u>
September 30, 1996	<u>\$ 150,000</u>	<u>\$ 56,700</u>	<u>\$ 265,000</u>	<u>\$ 471,700</u>
September 30, 1996	\$ 150,000	\$ 56,700	\$ 265,000	\$ 471,700
Recoveries	13,100	11,100	18,500	42,700
Realized losses	(23,900)	(900)	(28,700)	(53,500)
Provision	<u>57,000</u>	<u>(10,200)</u>	<u>0</u>	<u>46,800</u>
September 30, 1997	<u>\$ 196,200</u>	<u>\$ 56,700</u>	<u>\$ 254,800</u>	<u>\$ 507,700</u>

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Ginnie Mae incurs loss when insurance and guarantees do not cover expenses that result from issuer defaults. Such expenses include (1) unrecoverable losses on individual mortgage defaults because of coverage limitations on mortgage insurance or guarantees, (2) ineligible mortgages included in defaulted Ginnie Mae pools, (3) improper use of proceeds by an issuer, and (4) non-reimbursable administrative expenses and costs incurred to service and liquidate portfolios of defaulted issuers.

The reserve for losses is relieved as estimated losses are realized. To the extent realized losses differ from those previously estimated, Ginnie Mae may elect to increase or decrease its reserve depending on its assessment of risks and losses associated with probable issuer defaults. For fiscal year 1997 Ginnie Mae increased its provision for losses for its single-family portfolio to reflect increased risk with respect to recovery of certain losses and expenses associated with issuer defaults. At September 30, 1997, the balances of Ginnie Mae managed portfolios were \$606.7 million in single-family, \$0 in multifamily, and \$220.3 million in manufactured housing, and in fiscal year 1996, \$315.8 million in single-family, \$38.0 million in multifamily and \$332.2 million in manufactured housing. As Ginnie Mae's defaulted issuer portfolio decreases, original estimates are compared with actual results over time and the adequacy of the reserve is assessed and if necessary, the reserve is adjusted.

#### **NOTE G--FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK**

Ginnie Mae is subject to credit risk for financial instruments not reflected in its balance sheet in the normal course of operations. These financial instruments include guarantees of mortgage-backed securities and commitments to guaranty mortgage-backed securities. The Ginnie Mae guaranteed security is a pass through security whereby mortgage principal and interest payments, except for servicing and guaranty fees, are passed through to the security holders monthly. Mortgage prepayments are also passed through to security holders. As a result of the structure of the security, Ginnie Mae bears no interest rate or liquidity risk. Ginnie Mae's exposure to credit loss is contingent on the event of non-performance by other parties to the financial instruments. Other than those issuers considered in the reserve for loss on the MBS program (see Note F), Ginnie Mae does not anticipate non-performance by the counterparties.

Ginnie Mae guarantees the timely payment of principal and interest to mortgage-backed security holders should the issuers fail to do so. The securities are backed by pools of insured or guaranteed FHA, RHS or VA mortgage loans. On September 30, 1997 the amount of securities outstanding which are guaranteed by Ginnie Mae was \$531 billion; however, Ginnie Mae's potential loss is considerably less because the underlying mortgages serve as primary collateral and the FHA, RHS and VA insurance or guarantee serve to indemnify Ginnie Mae for most losses.

During the mortgage closing period and prior to granting its guaranty, Ginnie Mae enters into commitments to guaranty mortgage-backed securities. The commitment ends when the securities are issued or the commitment period expires. Ginnie Mae's risk related to outstanding commitments is much less than for outstanding securities due, in part, to Ginnie Mae's ability to limit commitment authority granted to individual issuers of mortgage-backed securities.

Outstanding MBS securities and commitments were as follows (in billions):

	September 30,	
	<u>1997</u>	<u>1996</u>
Outstanding MBS securities	\$ 531	\$ 497
Outstanding MBS commitments	\$ 31	\$ 33

## NOTE H--CONCENTRATIONS OF CREDIT RISK

Concentrations of credit risk exist when a significant number of counterparties (e.g., issuers and borrowers) engage in similar activities or are susceptible to similar changes in economic conditions that could affect their ability to meet contractual obligations. Generally, Ginnie Mae's MBS pools are diversified among issuers and geographic areas. No significant geographic concentrations of credit risk exist; however, to a limited extent, securities are concentrated among issuers as noted below as of September 30, 1997 (dollars in billions):

Portfolios of	<u>Single-Family</u>		<u>Multifamily</u>		<u>Manufactured Housing</u>	
	Number of Issuers	Remaining Principal Balance	Number of Issuers	Remaining Principal Balance	Number of Issuers	Remaining Principal Balance
Largest performing issuers	15	\$ 336.4	10	\$ 9.3	1	\$ 0.9
Other performing issuers	329	178.5	131	4.3	5	0.3
Defaulted issuers	10	0.6	0	0.0	23	0.2

During fiscal year 1997, Ginnie Mae acquired 4 single-family issuer portfolios with a remaining principal balance of \$350.6 million.

In fiscal year 1997, Ginnie Mae issued a total of \$27.7 billion in its multiclass securities program. The outstanding balance at September 30, 1997 was \$51.8 billion. These guaranteed securities do not subject Ginnie Mae to additional credit risk beyond that assumed under the MBS program.

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## **NOTE I--COMMITMENTS AND CONTINGENCIES**

As of September 30, 1997, Ginnie Mae was named in several legal actions, virtually all of which involved claims under the guarantee program. It is not possible to predict the eventual outcome of the various actions; however, in the opinion of management and counsel the resolution of these claims will not result in adverse judgments to such an extent they would materially affect the financial position or results of operations of Ginnie Mae.

## **NOTE J--RELATED PARTIES**

Ginnie Mae is subject to controls established by government corporation control laws (32 U.S.C. 9101 through 9109) and management controls by the Secretary of HUD and the Director of the Office of Management and Budget (OMB). Such controls could affect Ginnie Mae's financial position or operating results in a manner that differs from those that might have been obtained if Ginnie Mae were autonomous.

HUD provides Ginnie Mae, without charge, use of office space and equipment. Ginnie Mae reimbursed HUD \$9.3 million in 1997 and \$9.1 million in 1996 for administrative expenses allocated to Ginnie Mae including payroll and payroll related costs.

Payroll related costs for which Ginnie Mae reimbursed HUD included matching contributions to the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS). Although Ginnie Mae funds a portion of pension benefits under these programs, it has no liability for future payments to employees under these programs and does not account for the assets of CSRS or FERS nor does it have actuarial data with respect to accumulated plan benefits or the unfunded pension liability relative to its employees. These amounts are reported by the Office of Personnel Management (OPM) and are allocated to HUD. OPM also accounts for the health and life insurance programs for Federal employees and retirees and funds the non-employee portion of the costs of such program.

Cash receipts, disbursements and investment activities are processed by the U.S. Treasury. Funds in the U.S. Treasury represent cash currently available to finance purchase commitments and pay current liabilities. Ginnie Mae has authority to borrow from the U.S. Treasury to finance its operations in lieu of appropriations if necessary.

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## NOTE K--FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table shows the fair value of financial instruments to which Ginnie Mae has a contractual obligation to deliver or a contractual right to receive cash from another entity as of September 30, 1997 and 1996 (in thousands):

<u>Financial Instrument</u>	Fair Value	
	<u>1997</u>	<u>1996</u>
U.S. Government Securities	\$5,445,500	\$4,748,100
Funds in U.S. Treasury	\$155,800	\$131,200
Advances against MBS Pools	\$29,100	\$29,500
Other Assets	\$113,000	\$91,000
Unrecognized Financial Instruments	\$1,132,300	\$1,086,00
Other Liabilities	\$40,600	\$37,300

The fair value of Ginnie Mae's largest asset, U.S. Government Securities, is estimated based on quoted market prices for securities of similar maturity. The fair values of Funds in U.S. Treasury, Advances against MBS Pools, Other Assets and Other Liabilities are not materially different from their carrying values.

Unrecognized financial instruments comprise the net fair value of the fee Ginnie Mae receives for the guarantee of timely payment of principal and interest. The value was derived by discounting the estimated future net cash flows relating to Ginnie Mae guaranteed mortgage-backed securities outstanding. The assumptions and estimates used in calculating the fair value of unrecognized financial instruments are based on management's evaluation of economic conditions and, therefore, are not subject to precise quantification. These discounted cash flows consist of estimated future guaranty fees, taking into account estimated prepayments, in excess of 1) projected losses relating to the MBS program, including projected losses on defaulted pools of mortgage-backed securities, and 2) projected administrative expenses. The discount rate approximates an interest rate for risk-free instruments of a tenor and duration similar to the Ginnie Mae guarantee. The fair value of Ginnie Mae's guarantee recognizes the present value of future fees which are not recognized under generally accepted accounting principles since to do so would record revenue prior to realization. The decrease in the fair value of unrecognized financial instruments is primarily attributable to the impact of interest rate volatility.

Ginnie Mae's standing as a Federal government corporation whose guarantee carries the full faith and credit of the U.S. Government makes it difficult to determine what the fair value of its financial instruments would be in the private market. Accordingly, the amount Ginnie Mae would realize upon sale of its financial instruments could differ, perhaps materially, from the amounts shown above.

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## **NOTE L--CREDIT REFORM**

The primary purpose of the Federal Credit Reform Act of 1990, which became effective on October 1, 1991, is to more accurately measure the cost of Federal credit programs and to place the cost of such credit programs on a basis equivalent with other Federal spending. Credit Reform focuses on those credit programs that operate at a loss by providing for appropriated funding, within budgetary limitations, to subsidize the loss element of the credit program. Negative subsidies, calculated for credit programs operating at a profit, normally result in the return of funds to Treasury. OMB specifies the methodology an agency is to follow in accounting for the cash flows of its credit programs.

Ginnie Mae's credit activities have historically operated at a profit. Ginnie Mae has not incurred borrowings or received appropriations to finance its credit operations, nor does it anticipate the need to receive such funding. As of September 30, 1997, Ginnie Mae had an investment in U.S. Government of \$5.1 billion after establishing reserves for potential losses on its credit activities. Pursuant to the statutory provisions under which Ginnie Mae operates, its net earnings are used to build sound reserves. In the opinion of management, Ginnie Mae is in compliance with OMB implementation requirements for the Federal Credit Reform Act.

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Andrew Cuomo

Secretary

**Ginnie Mae**

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President

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